SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1927.

No. 425

MIDLAND NATIONAL BANK OF MINNEAPOLIS, PETITIONER,

vs.

DAKOTA LIFE INSURANCE COMPANY, RESPONDENT.

PETITIONER'S BRIEF.

Statement.

The petitioner brought this action in a state court against respondent who caused the action to be removed to the United States District Court for Minnesota on the ground of diversity of citizenship (R., 1-10). The pleadings were there several times amended. There was a Complaint (R., 2-4), and Amended Answer (R., 10-23), and Amended Complaint (R., 24-35), and Answer to Amended Complaint (R., 35-39*j*). A

large part of the Answer to the Amended Complaint was stricken out on motion on the ground that the stricken portions were sham, irrelevant, and redundant matter (R., 40-45). Thereafter on motion respondent obtained leave to amend its pleading by substituting an amended answer which appears in the record entitled "Proposed Amended Answer to Amended Complaint" (R., 46-53). To this petitioner filed its Reply (R., 53-55).

Thus, when the parties came to trial, the issues were framed by the Amended Complaint, the so-called "Proposed Amended Answer to Amended Complaint" and the Reply. It should be helpful to understand what these issues were.

The Amended Complaint alleged that on May 14, 1920, in the State of North Dakota, respondent made and delivered to one Oscar Mosher a policy of insurance on the life of said Mosher in the sum of $10,000. The policy was payable to the estate of Mosher (R., 24). So much was admitted by respondent because not denied either generally or specifically. Petitioner also alleged that on October 10, 1921, Mosher assigned the policy to one J. E. Jacobson (R., 24, 25). This was not denied by respondent's pleading, but respondent alleged that this assignment was to secure a pre-existing indebtedness in the sum of $5,686.08, then owing by Mosher to the Dazey State Bank, of which Jacobson was president (R., 47). The Amended Complaint alleged further that on February 26, 1923, both Mosher and Jacobson assigned the policy to petitioner (R., 25). This assignment recited that it was "given to

secure the payment'' to petitioner of ''the sum of Ten Thousand and 00/100 Dollars, according to the tenor and conditions of two promissory notes'' (R., 34). Respondent admitted the execution of this assignment (R., 49), but alleged that on January 13, 1923, two $5,000 notes were obtained from Mosher and his wife as makers, payable to the order of Jacobson, by means of fraudulent misrepresentations that such notes were in renewal of an indebtedness of the Moshers to the Dazey Bank in the sum of $4,193.84, whereas there was in fact no indebtedness whatever owing to Jacobson, and that the assignment of February 26, 1923, was also obtained from Mosher through the fraudulent misrepresentation that it was given to secure the said indebtedness to the Dazey State Bank rather than the two $5,000 notes (R., 48, 49). In this connection respondent also conceded that the two $5,000 notes were endorsed by Jacobson to petitioner as collateral security to a pre-existing indebtedness of Jacobson to petitioner in a larger amount. The other allegations in the Amended Complaint setting forth the death of Mosher, the payment or extension of premiums, the giving of notice and proof of death by petitioner were not controverted.

The respondent pleaded a decree in a State court in North Dakota, in a suit commenced June 19, 1923, to which petitioner concededly was not a party, cancelling the policy as against the administratrix of Mosher (R., 49, 50).

Petitioner proved at the trial in support of the allegations in the Reply (R., 53-55) that the two $5,000

notes endorsed by Jacobson were received by it on March 2, 1923, as collateral security for a larger indebtedness on the part of Jacobson to petitioner; that the policy and two assignments were received at the same time as collateral for the two $5,000 notes (the policy thus being [illegible] Jacobson's indebtedness and liability to pe[illegible] that petitioner became the absolute owner of the two $5,000 notes through foreclosure sale of the pledged property and that nothing was ever paid on the notes (R., 69-83).

Respondent's offer of an authenticated copy of the findings and judgment in the North Dakota action was refused on the ground that the exhibit was immaterial and irrelevant (R., 96, 97, 167-175).

Respondent also made a lengthy offer to prove by three witnesses, Sophia Mosher, Ladbury and Bell, that there was a lack of consideration and (possibly) fraud practiced upon Mosher in connection with the delivery of the two $5,000 notes in January, 1923 (R., 102-107). *These offers had no reference whatever to what transpired in connection with the issuance of the policy in 1920.* The offered testimony was excluded on the ground that it was immaterial and irrelevant matter, and that proof of fraud practiced upon Mosher in procuring an assignment of the policy would not constitute a defense available to the insurance company (R., 107-108).

Both parties having moved for a directed verdict (R., 109), the trial judge made a general finding in favor of petitioner for the full amount claimed (R.,

57). See opinion, R., 58-61. Judgment was entered accordingly (R., 58).

The cause thereupon came before the Circuit Court of Appeals for the Eighth Circuit upon writ of error. There were six assignments of error as follows:

> 1 and 2, assigning the order of the trial court in striking out portions of the Answer to the Amended Complaint (R., 179).
>
> 3, assigning the exclusion from evidence of the North Dakota judgment (R., 180).
>
> 4, 5, and 6, assigning the denial of the offers of proof by witnesses Sophia Mosher, Ladbury and Bell (R., 180-182).

In its opinion (by Lewis, J.) the appellate court sustained the trial court as to the matters covered by assignments 1, 2, and 3, *supra* (R., 193-198). But in paragraph numbered 4 of the opinion the court held that "on the proof and the tendered and rejected proof" the policy was a wagering contract and void in its inception in 1920 except to the extent of the then indebtedness of Mosher, the insured, to the Dazey State Bank. The opinion erroneously stated such indebtedness "the answer alleged, amounted to $5,686.08 at the time the policy issued" (R., 194). In fact there was no evidence or allegation showing what, if any, indebtedness there was at that time.

Section 6635*c* of the Compiled Laws of North Dakota, 1913, required the policy in question to contain "a provision that the policy shall constitute the entire contract between the parties and shall be incontestable

after two years from its date, except for non-payment of premiums and except for violations of the conditions of the policy relating to naval and military services in time of war." While the Circuit Court of Appeals held that this provision barred proof of fraud in the procurement of the policy (thereby sustaining the order of the trial court striking out portions of the answer to the Amended Complaint wherein such fraud had been alleged), it also held that such an incontestable clause would not bar a defense that the policy was a wagering contract, notwithstanding the lapse of more than two years.

The petitioner filed a petition for rehearing (R., 199-205), which was denied May 26, 1927, without further opinion (R., 206).

ARGUMENT.

First Point

The circuit court of appeals has reversed the district court on matters of fact and on a point of law that were not before the district court.

1. It is stated at the beginning of the opinion of the court below:

> "The questions that are reviewable on this writ relate to the exclusion of offered proof in the light of the pleadings * * *." (R., 193.)

And at the end of the opinion the court says:

> "So we conclude on the facts stated that the policy was a good and valid contract to the extent of Mosher's indebtedness to the Dazey

> State Bank on May 14, 1920, and that the court erred in excluding the tendered proof. If the tender should be made good and the case does not present a materially different aspect from the record before us, plaintiff should have judgment for that amount, with interest from service of summons." (R., 198.)

From this it sufficiently appears that the reversal was based solely on the exclusion of proof at the trial.

2. As already stated the validity of the policy in its inception in 1920 was not in issue under the pleadings, but on the contrary admitted. As already stated the excluded proof had reference only to matters alleged to have transpired in 1923 in connection with the assignment of the policy to petitioner.

The only possible questions in the case when the parties came to trial were:

> 1. Was fraud practiced upon the assignor of the policy and, if so, would it be a defense to the insurance company?
>
> 2. Was the decree of cancellation of the policy by the North Dakota court a defense to the insurance company?
>
> 3. Was petitioner entitled to a full recovery, having received the two $5,000 notes, and the assignment of the policy as collateral security for a pre-existing indebtedness?

It is certain that no other questions were considered to be in the case by the trial judge. See opinion (R., 58-61).

We quote from the statement in the opinion of the Circuit Court:

> "That company (respondent) offered to show that the policy was applied for and issued at the instigation of Jacobson; that he retained possession of it for the Dazey State Bank; that Mosher assigned it to that bank when it was issued and that bank paid the first and all other premiums; * * * that at the time and for some time theretofore Mosher had tubercular consumption in an advanced state and continued in that condition until his death which occurred on September 10, 1923; * * * that Mosher never had or kept the policy under his control, that it was taken out by and solely for the benefit of his creditor, the Dazey State Bank * * *." (R., 194-195.)

To one who reads the opinion carefully it becomes obvious that the entire texture of the wager argument it built upon the foregoing recitals. *Yet the matters stated were not contained in the rejected offers of proof; they were not even alleged in the pleadings as amended when the parties came to trial; there was no evidence of such matters actually received or offered.* There was nothing, absolutely nothing, in the amended pleadings, the evidence received, or the rejected proof out of which the court could weave a wager contract. A reversal of the judgment of the trial court based upon such a profound misapprehension of the record is, in our experience, quite without precedent. Yet the petition for rehearing wherein these manifest errors were pointed out was denied without further opinion.

If the judgment of the Circuit Court of Appeals is not reviewed and reversed, the district court will be confronted with several embarrassing questions upon the new trial. Is the proof which that court is required to receive the proof actually offered on the first trial, or the proof which the appellate court says was offered? If the latter, is the trial court to permit amendments of the pleadings so that issues will be raised which are in conformity with the evidence?

3. It seems to us that the reversal of the judgment of the trial court for the exclusion of testimony, which in fact was never offered, and which, if it had been offered, would not have been relevant to any issue in the case, was a departure "from the accepted and usual course of judicial proceedings," as that phrase is used in Rule 35 of this Court. If not, it is difficult to conceive what would be such a departure. We submit that this Court should exercise its power of supervision in extreme cases like the present in order that the great confidence which the bar and public now has in the Federal judiciary may be maintained.

Second Point.

Even if the Record were as the court below understood it to be the incontestable clause would bar any controversy as to the validity of the policy in its inception.

1. In a limited number of cases the courts have held that an incontestable clause in a life insurance policy, in so far as the defense of wager or lack of insurable

interest is concerned, is contrary to public policy and ineffectual *pro tanto* even after the contestable period has expired.

Bromley's Ad'r *vs.* Washington Life Ins. Co., 122 Ky., 402; 92 S. W., 17.

Clement *vs.* N. Y. Life Ins. Co., 101 Tenn., 22; 46 S. W., 561.

Contra:

Wright *vs.* Mutual Benefit Life Assn., 118 N. Y., 237.

2. Where a life insurance policy is issued with the consent of the person whose life is insured, it is difficult to see why the incontestable clause should not bar the assertion that the real beneficiary had no insurable interest in the life insured. In such cases the only valid objection that can be made to enforcing the contract is that it is in the nature of a bet on the part of the party effecting the insurance as to the duration of the life insured.

See Grigsby *vs.* Russell, 222 U. S., 149.

There is no sound reason why the law should take a more violent objection to such a transaction than to a contract of insurance procured by fraud. As to fraud the authorities are agreed that the lapse of a reasonable period specified by an incontestable clause will be a bar.

Mutual Life Insurance Co. *vs.* Hurni Company, 263 U. S., 167.

3. The decisions adverse to petitioner's contention are all cases where the incontestable clause was a private arrangement between the parties which was considered to contravene public policy. Such decisions have no application where the incontestable clause is required by the governing statute. Public policy is to be determined by the appropriate legislatures, in this case the North Dakota legislature. *When that legislature has said that the policy shall be incontestable after two years, it is indefensible for any court to hold that it knows better about public policy, or to read exceptions into the clause which are not there.*

In Whitfield *vs.* Ætna Life Ins. Co., 205 U. S., 489, this Court said:

> "An insurance company is not bound to make a contract which is attended by the results indicated by statute in question. If it does business at all in the State, it must do so subject to such valid regulations as the State may choose to adopt. Even if the statute in question could be fairly regarded by the court as inconsistent with public policy or sound morality it cannot for that reason alone be disregarded; for it is the province of the State by its legislature to adopt such a policy as it deems best, provided it does not, in so doing, come into conflict with the Constitution of the State or the Constitution of the United States."

4. In Northwestern Life Ins. Co. *vs.* Johnson, 254 U. S., 96, this Court held that an incontestable clause reading—"This contract shall be incontestable after one year from the date of its issue, provided the re-

quired premiums are duly paid" could only be construed as barring the defense of suicide after the period indicated. Mr. Justice Holmes said in the opinion:

> "The public policy with regard to such contracts is a matter for the States to decide. * * * The object of the clause is plain and laudable—to create an absolute assurance of the benefit, as free as may be from any dispute of fact except the fact of death, and as soon as it reasonably can be done. It is said that the insurance companies now generally issue policies with such a clause. The State decisions, so far as we know, have upheld it. Unless it appears that the State concerned adopts a different attitude we should uphold it here."
>
> See also Lee *vs.* Southern Life & Health Co., 19 Ala. App., 535; 98 So., 696.

Public policy is concerned as much with suicide as with the absence of insurable interest. Accordingly the decision of the Circuit Court of Appeals seems repugnant to the rules laid down in the Johnson case as well as opposed to sound principles.

5. The question here presented is one of considerable importance. The volume of life-insurance contracts written in this country is staggering. There is a great deal of State legislation as to provisions required in such contracts, standard forms, etc. If, notwithstanding such legislative requirements, the Federal courts should hold REQUIRED provisions to be against public policy or otherwise inoperative, it would be a matter of considerable consequence.

THIRD POINT.

Even if the Record were as the court below understood it to be, that court erred in holding the policy a wagering contract as a matter of law.

1. Even if the circuit court of appeals had been correct and the reception of the offered proof would have established that the policy had been taken out for the protection of the Dazey State Bank as a creditor of the life insured, in the sum of $5,686.08 according to the court's understanding, it was error for the court to hold that the policy was invalid as to the excess over the then indebtedness as a matter of law.

The rule is that where a creditor insures or causes to be insured the life of his debtor he is entitled to recover the full amount of the insurance unless there is such a gross discrepancy between the amount of the debt and the amount of the insurance that the transaction shows on its face that it is a mere wager. The dictum in Connecticut Mutual Life Ins. Company *vs.* Schaefer, 94 U. S., 457, 462, that "the amount of insurable interest is the amount of the debt" does not accurately state the law on this subject.

Insurance Company *vs.* Bailey, 13 Wall., 616, 619.

Insurance Company *vs.* Mowry, 96 U. S., 544, 545.

Connecticut Mut. Life Ins. Co. *vs.* Lucks, 108 U. S., 498.

Sides *vs.* Knickerbocker Life Ins. Co., 16 Fed., 650.

Amick *vs.* Butler, 111 Indiana, 578.
Rittler *vs.* Smith, 70 Maryland, 261; 16 Atl., 890.
37 Corpus Juris, 396.

Now a $10,000 policy to secure an indebtedness of $5,686.08, when the interest to accrue on the indebtedness and the cost of maintaining the insurance is taken into consideration (in this case the annual premium was $394.20; R., 28) is not such a gross discrepancy as to show bad faith. On the contrary such a substantial indebtedness, in the light of the decisions on the subject, would appear to take the question of insurable interest out of the case.

In the decision of the Circuit Court of Appeals it is said:

> "The insurable interest of the Dazey State Bank was limited to an account reasonably adequate to cover Mosher's indebtedness to it and premiums which it would have to pay and interest." (R., 197.)

But in what follows and in the conclusion of the opinion there is language from which respondent will contend, in case of a new trial, that petitioner's recovery is limited to the exact indebtedness at the time the policy was issued. The effect of this would be to make the question of insurable interest when the policy is issued depend on subsequent events, such as the amount of premiums paid, interest accumulated, etc. Such a rule is contrary to sound principles.

Conn. Mutual Life Ins. Co. *vs.* Schaefer, 94 U. S., 457.

The decision of the court below also seems in conflict with the North Dakota statutes dealing with this subject:

> "Every person has an insurable interest in the life and health * * * Of any person under a legal obligation to him for the payment of money, or respecting property or services, of which death or illness might delay or prevent the performance * * *." Comp. L. 1913, Sec. 6628.
>
> "Unless the interest of a person insured is susceptible of exact pecuniary measurement, the measure of indemnity under a policy of insurance upon life or health is the sum fixed in the policy." Id., Sec. 6631.

If there was any question of insurable interest under the court's view of the record, that question would be determined by the good faith or bad faith of the creditor, the Dazey State Bank. That question was for the jury.

Cooley, Briefs on Insurance, Vol. I, page 328.

In the public interest, as well as in justice to the petitioner, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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